

November 7, 2011

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Use of Derivatives by Investment Companies under the Investment Company Act of 1940, as amended (File No. S7-33-11)

Dear Ms. Murphy:

Loomis, Sayles & Company, L.P. (“Loomis Sayles”)¹ is pleased to comment on the release by the Securities and Exchange Commission (the “Commission”) on the use of derivatives by investment companies under the Investment Company Act of 1940, as amended (the “1940 Act”).² Loomis Sayles commends the Commission for seeking the investment management industry’s input on ways to improve the current regulatory regime in light of the ways that funds³ use derivatives.

Although the Release addresses a broad range of issues associated with the use of derivatives, Loomis Sayles wishes to address the Commission’s concern that the use of derivatives by funds may involve the potential leveraging of a fund’s assets. In sum, Loomis Sayles believes that the existing Commission guidance that any leveraged transaction be “covered” continues to be appropriate. However, we believe that the industry would benefit from additional Commission guidance on the methods by which advisers and funds can evaluate and calculate appropriate cover amounts.

¹ Loomis Sayles, founded in 1926, is a registered investment adviser and a subsidiary of Natixis Global Asset Management. Loomis Sayles provides diversified investment management capabilities and products to mutual funds, institutional separate accounts, collective trusts and other client types across a full spectrum of domestic and global equity and fixed income disciplines.

² See Use of Derivatives by Investment Companies under the Investment Company Act of 1940, SEC Release No. IC-29776 (August 31, 2011) (the “Release”).

³ The term “fund” herein is intended to encompass open-end management investment companies and closed-end management investment companies, as defined in the 1940 Act. See Section 5 of the 1940 Act.

Benefits of Derivatives

While one effect of engaging in derivatives transactions may be to create leverage in a fund, derivatives can also be used for other purposes. Derivatives can be used as an efficient means to gain investment exposure to an issuer or an asset class or as a valuable hedging tool. For example, credit default swaps may be used to gain investment exposure to an issuer when the issuer's bonds are otherwise unavailable. In addition, credit default swaps may provide an effective way to obtain short exposure to an issuer of fixed income securities, either as a hedge or for investment purposes, which may not otherwise be possible through traditional means. Other derivatives, such as futures, can efficiently be employed to manage a portfolio's duration without the need to change the fund's underlying investments. Derivatives can also at times enhance liquidity. During the recent credit crisis in 2008, and in subsequent periods of volatility, derivatives maintained greater liquidity than even delivery-versus-payment securities.

Nonetheless, as discussed in the Release and mentioned above, a fund's use of derivatives may create leverage risk. Leveraged transactions may be deemed to be senior securities and therefore implicate Section 18 of the 1940 Act and the rules and regulations thereunder.⁴ As the SEC Staff has indicated in Release 10666 and in related no-action letters, a derivatives transaction will not be deemed to be a senior security, and leverage risk may be mitigated, if a fund "covers"⁵ its potential obligations.

Funds Should Be Able To Establish Customized Risk Management Calculations Appropriate for Their Activities

Loomis Sayles believes that the current guidance requiring segregation or earmarking⁶ of an amount of cover is the appropriate method to counteract the leverage that occurs when a fund enters into a derivative transaction. However, like the Commission, Loomis Sayles has noted the limitations of segregating or earmarking either the notional amount (the full amount of the reference asset) or the mark-to-market value of the derivative contract (the amount of the unrealized gain or loss on the transaction).

Therefore, Loomis Sayles encourages the Commission to focus its efforts on the formal process used by funds and their investment advisers to determine and calculate the cover amounts associated with derivative transactions in order to manage leverage risk. Loomis Sayles concurs with the views expressed by the 2010 ABA Derivatives Task

⁴ See Section 18 of the 1940 Act; see also Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (April 18, 1979) ("Release 10666").

⁵ See Id.

⁶ See "Dear Chief Financial Officer" Letter from Lawrence A. Friend, Chief Accountant, Division of Investment Management (pub. avail. Nov. 7, 1997).

Force that specific comprehensive guidance is unlikely to be achievable. Our experience has been that there is not a “one-size fits all” approach, as the analysis must consider the type of derivative as well as its intended use for the particular fund. A comprehensive, standardized set of requirements will likely fail to take into account significant variations in individual terms which are the hallmark of derivatives transactions.

Thus, we support an alternative, principles-based approach, pursuant to which funds would establish their own asset segregation standards for derivative instruments, within certain general guidelines established by the Commission. This principles-based approach should require every fund to establish a policy to ensure that it has assets available to meet all of its obligations based on realistic, reasonable and current expectations of the potential for loss to the fund.

The parameters of such an asset segregation standard could build upon the current notional and mark-to-market value concepts. Mark-to-market and notional values are empirical and straightforward means to implement, oversee and describe to investors. Building upon these accessible and easy to understand foundations, the standards should require a fund to take into consideration additional risk management calculations appropriate for the fund’s derivatives activities. Such calculations should be customized and flexible for each fund and fund manager, based on each fund’s circumstances.⁷

Under this approach, each fund would be required to adopt policies and procedures that would include, among other things, minimum asset segregation requirements for the specific context of its derivative transactions. In developing these standards, fund investment advisers could take into account a variety of risk measures they deem appropriate, such as value at risk (“VAR”) and other quantitative measures of portfolio risk. The resulting minimum risk adjusted segregated amount (“RASA”) would be reflected in policies and procedures that could be subject to approval by the fund’s board of directors. These factors, and in particular the principles underlying the RASA for different types of derivatives, could also be disclosed in the fund’s SAI. Further, investment advisers should be required to make periodic reports to the fund’s board with respect to their asset segregation policies.

An important part of this approach is the absence of pre-determined requirements for calculating the appropriate cover amount. The approach presumes that the Commission would not compel a fund to utilize any particular methodology, such as VAR, which may add unnecessary complexity to the analysis or may not bear any relationship to the

⁷ In addition, we encourage the Commission to require a fund’s investment adviser to periodically perform an analysis of the quality of securities used as cover. We believe that the quality of securities used to cover should be taken into consideration so that additional uncorrelated credit exposure is either not created or is addressed through the amount of cover a particular type of asset may provide.

investment process. We believe that a fund's investment adviser is in the best position to determine how to meet a fund's investment objective and manage the fund's investment risk.

By way of example, Loomis Sayles currently takes into consideration factors it deems relevant to each particular derivative it uses, as well as the purpose of entering into the transaction.⁸ Then, it establishes a RASA for the different derivatives. For certain derivatives used for non-hedging purposes (such as a long credit default swap through which a fund sells protection to gain exposure to a reference asset), it covers by segregating or earmarking liquid assets equal to 100% of the notional amount of the derivative, so that a fund has assets on hand that are not subject to credit risk in order to meet its obligations. For other derivatives used for hedging and non-hedging purposes (such as a long currency forward contract), it covers by segregating or earmarking liquid assets equal to a fund's mark-to-market obligation plus a premium, or buffer amount, based upon the perceived risk and potential volatility of the derivative. Factors considered in determining the volatility amount premium for a particular derivative include whether the derivative relates to a developed or emerging market; whether the derivative is based in a country with a low or high level of volatility; the tenor, liquidity and volatility of the derivative; and whether or not the reference asset is a member of the S&P 500 Index.⁹ Loomis Sayles may also apply additional constraints to limit a fund's exposure obtained through derivatives, such as duration bands that serve as outside limits on the use of these instruments.

Loomis Sayles believes an individualized manner of addressing the risk of leverage in derivatives transactions is consistent with, but improves upon, the current regime. Loomis Sayles's goal is to achieve a solution that is both conservative and easy to implement. It believes a similar solution could be employed by others in the investment management industry. Each investment adviser could be afforded the latitude to establish and impose a RASA for each derivatives transaction in which a fund it manages invests. With the added requirement of board approval of, and regular reporting on, such policies and procedures, fund investment advisers would be required to come up with a reasonable and supportable rationale for their treatment of derivatives. The disclosure of the methods used would serve to better inform investors of the true potential for leverage in derivatives utilized by a fund and about how the fund's adviser manages and mitigates such risk.

⁸ For example, Loomis Sayles considers whether the derivative will be used for non-hedging purposes, for hedging purposes or for duration/yield curve management.

⁹ For example, S&P Index futures have a higher credit risk than treasuries futures, therefore we would impose a greater buffer for those futures than we would on treasuries futures.

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Based on Loomis Sayles's experiences, derivatives not only can be used safely in a fund portfolio, but can also be beneficial, from an investment standpoint, for fund investors. With additional guidelines established by the Commission that provide investment advisers with the flexibility to analyze and establish appropriate cover amounts, derivatives should continue to be viewed as appropriate fund investments.

Thank you for considering our comments. Should you wish to discuss, please feel free to contact me at 617.346.9733.

Respectfully submitted,

A handwritten signature in blue ink that reads "Jean S. Loewenberg". The signature is fluid and cursive, with the first name "Jean" and last name "Loewenberg" clearly legible.

Jean S. Loewenberg
General Counsel and Executive Vice President
LOOMIS, SAYLES & COMPANY, L.P.

cc: The Honorable Mary L. Schapiro, Chair
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

Eileen P. Rominger, Director
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